



**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

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Order Instituting Rulemaking on the Commission's Own Motion to Develop Standard Rules and Procedures for Regulated Water and Sewer Utilities Governing Affiliate Transactions and the Use of Regulated Assets for Non-Tariffed Utility Services (formerly called Excess Capacity).

Rulemaking (R) 09-04-012

**REPLY COMMENTS OF THE CONSUMER FEDERATION OF CALIFORNIA
ON THE STAFF REPORT TO COMMISSIONER BOHN AND JUDGE GAMSON
RE OIR.09-04-012 AND RELATED WORKSHOPS**

The Consumer Federation of California (CFC) files these Reply Comments in accordance with the "Scoping Memo And Ruling Of Assigned Commissioner And Administrative Law Judge," issued November 4, 2009, and the "Administrative Law Judge's Ruling Modifying The Schedule," issued April 21, 2010, in this docket.

**Affiliate Transaction Rules Are Compatible
with Utility Operations, and Necessary**

California American Water Company (CalAm), in its Comments on the Staff's Workshop Report, argues that the rules proposed by staff of the Public Utilities Commission (Staff) are "incompatible" with CalAm's current method of doing business.¹ If adopted, CalAm would have to develop an independent utility structure to serve customers, purchasing only the goods and services it needs, and employing only the personnel it needs. No service company could load up the bills with inflated charges resulting from inefficient management, or with excessive compensation payments to its employees and experts. No service company could manipulate the allocations of costs incurred to purchase expensive or unnecessary equipment. Further, CalAm would be responsible only for the debts the utility incurs and the risks it encounters and manages.

¹ CalAm Workshop Comments (May 7, 2010) at 2.

After decades of holding company abuses, the United States determined that rules governing the interaction between a utility and affiliated companies were essential.² The holding company's primary interest is in making money. The utilities capital and securities were written up by, *inter alia*, by inflating construction costs. "The early 1930's holding companies were actually milking the operating companies in three ways:

1. The operating utility would borrow money on its good credit and then lend all or part of the proceeds to the holding company receiving only an unsecured note from the holding company.
2. The holding company would lend money to the operating company at interest rates well above what the operating company could have obtained in the market.
3. The operating company would be forced to pay unjustifiably high dividends to the holding companies.

In addition, the utility was forced to enter into management service contracts for construction and engineering services at fees set by the holding company, and were not permitted to look for lower cost services. The FTC found "many payments for services rendered had been exorbitant," judged by a standard of cost plus a fair margin of profit."³ The fees were passed on to ratepayers. "Those who cannot remember the past are condemned to repeat it."⁴

Holding Company Abuses Are Not a Thing of the Past.

Neither CalAm, nor any other water company is able to say their relationships with their holding companies will not follow the same pattern. There have been instances of similar practices in the recent past, e.g., transfer of inflated assets (A.05-08-021), allocations to support holding company projects (A.08-01-004), allowing an affiliate to use utility assets (D.07-12-055), high cost borrowing (Decision 08-11-025), exorbitant rents (D.08-40-018).⁵ CWA attempts to sweep them under the rug when it argues "the current process of crafting water utility affiliate transaction rules has been almost devoid of any factual record identifying any specific problems requiring remediation."⁶

² *Public Utility Holding Company Act of 1935: 1935-1992.*, DOE/EIA 0563, Energy Information Administrator, U.S. Dept. of Energy, Washington, D.C. (1993)
<http://tonto.eia.doe.gov/ftproot/electricity/0563.pdf>

³ PUHCA 1935 at 4.

⁴ George Santayana.

⁵ See, CFC Opening Comments (July 16, 2009) at 12.

⁶ CWA Workshop Comments (May 7, 2010) at 2

The Need For Affiliate Transaction Rules Is Not Dependent on A Finding that Competition Exists in the Water Industry.

CWA attempts to turn the focus away from these abuses of affiliate transactions to what it claims is “the principal goal of affiliate transactions rules for water utilities,” to remove the “obvious advantage of the incumbent utility as we move toward increasing competition, ... [and] promote a level playing field which is vital for competition to flourish.”⁷ No one has argued that the affiliate transaction rules for water companies are necessary because of an increasingly competitive market. This is a red herring, meant to mislead.

CWA relies on the absence of competition in the market for water services to claim there is no need for rules “prohibiting disclosure of customer or non-public and proprietary information by a utility to its affiliates ... as well as the draft rules strictly regulating the transfers of employees between a utility and its affiliates and *vice versa*.”⁸ In fact, utility customers are very interested in keeping non-public information private, whether or not competition exists, as demonstrated in the Commission’s Smart Grid proceeding (R.08-12-009). And a utility and its affiliate may not share the same interests, as was demonstrated by service companies’ ‘milking’ of utility assets. Confidences about what the utility can afford to pay for services would have been very useful to managers of the service company.

California Water Company (Cal Water) similarly argues, “Absent evidence of the exercise of market power, there is no basis for additional regulation over and above the existing state and federal antitrust laws to which the companies are already subject. Those laws and their enforcement mechanisms are plainly adequate to protect consumers and competitors without Commission action.”⁹ CFC disagrees. “Legislatures rely on rulemaking to add more detailed scientific, economic, or industry expertise to a policy -- fleshing out the broader mandates of authorizing legislation. For example, typically a legislature would pass a law mandating the establishment of safe drinking

⁷ CWA Workshop Comments (May 7, 2010) at 4.

⁸ CWA Workshop Comments (May 7, 2010) at 6.

⁹ Cal Water Workshop Comments (May 7, 2010) at 4, *citing*, See *Cel-Tech Communications Inc. v. Los Angeles Cellular Co.*, 20 Cal. 4th 163, 170-71 (1999).

water standards, and then assign an agency to develop the list of contaminants and safe levels through rulemaking.”¹⁰

Rules Provide Notice of Reasonable and Unreasonable Practices.

What constitutes a reasonable practice for utilities with affiliates needs to be spelled out in Commission rules. The affiliate transaction rules explain that it is not O.K. to require customers to pay excessive prices for goods and services that can be bought on the market at a lower price. It is not O.K. for a utility to lend money to an affiliate and not require that the loan be repaid. And so forth Providing notice of practices that should be avoided assists both the utility and consumers who are dissatisfied with utility rates.

CalAm argues that “any affiliate rule for the water industry should contain clear exemptions with regard to transactions between the utility and its parent that are necessary or conducive to good corporate governances and access to capital.”¹¹ CFC agrees that there must be some procedure whereby a utility is able to demonstrate the damage application of the rules would cause harm to its particular operations. But any exemption proposed by the water utilities, if incorporated in the rules, is likely to swallow the rules.

ALTERNATIVE DISPUTE RESOLUTION

CWA requests the administrative law judge to appoint or provide a neutral ALJ or other Commission personnel to facilitate the parties’ continued discussion of matters in this proceeding. CFC does not object to the proposal, but believes arbitration would be fruitless. After 6 days in four workshops, the CWA, acting on behalf of nearly all the utilities, remains opposed to most of the rules, as demonstrated by the Staff’s spreadsheet:

- CWA wants to overrule all previous orders affecting affiliate transactions.
- CWA wants to narrow the definition of affiliate so that fewer transactions are subject to the rules.
- CWA wants to eliminate the prohibition against closing local offices.

¹⁰ Wikipedia, “Rulemaking”. <http://en.wikipedia.org/wiki/Rulemaking>

¹¹ CalAm Workshop Comments at 3.

- CWA is opposed to the requirement that the parent holding company supply the utility with sufficient capital to fulfill all of its service obligations prescribed by the Commission.
- CWA does not want utilities to be required to retain equity “such that the Commission’s adopted capital structure shall be maintained on the average over the period the capital structure is in effect for ratemaking purposes.”
- CWA is opposed to ring-fencing.
- CWA does not want to be required to make available the officers and employees of the utility and its affiliated companies to appear and testify in any proceeding before the Commission involving any transaction between the utility and the affiliate.
- CWA does not want the rules to require the utility and its affiliated companies to “provide the Commission, its staff, and its agents with access to the relevant books and records of such entities in connection with the exercise by the Commission of its regulatory responsibilities in examining any of the costs sought to be recovered by utility in rate proceedings.”
- CWA wants to allow the sharing of market analysis reports or any other types of proprietary or non-publicly available reports, including but not limited to market, forecast, planning or strategic reports, with its affiliates
- CWA wants to be allowed to share customer information with its affiliates, without customer authorization
- CWA wants to eliminate the prohibition against sharing office space, office equipment, services, and systems with its affiliates, and giving access to its computer systems to an affiliate “except to the extent appropriate to perform shared corporate support functions permitted under Rule V (Shared Corporate Services).”
- CWA wants to eliminate the prohibition against sharing employees, the requirement that their movements from the utility and back be tracked, and the requirement that an affiliate compensate the utility for the loss of its employee

- CWA wants to eliminate the requirement that the utility be given first claim to the services of shared employee, and the requirement that no more than 5% of full time equivalent utility employees may be on loan at a given time;
- CWA has agreed, more or less, to the rules about pricing goods and services by the utility and its affiliates – fully allocated cost for sales by utility; fair market value” for sales to the utility --- it is opposed to developing “a verifiable and independent appraisal of fair market value for any goods or services that are transferred to any affiliated company.”
- CWA does not want to file a compliance plan after the rulemaking ends, and biennially thereafter, nor does it want to notify the Commission of new affiliates, the affiliate’s purpose or activities, and the procedures in place that will assure compliance with these affiliate transaction rules.
- CWA is opposed to the requirement that an independent auditor examine the books every two years.

Another issue to be considered with respect to CWA’s proposal is the effect to be given the arbitrator’s decision. If it is not binding, then the parties will have to go through the same process of explaining their positions as they will before the Commission, a waste of time and resources. If the arbitrator’s decision is binding, there must be a waiver by all parties of the right to a Commission decision.

WHEREFORE, for all the reasons stated herein, the Consumer Federation of California respectfully requests the Administrative Law Judge to consider the papers before him, and decide what rules should be adopted, without waiting for further discussions among the parties.

DATE: May 17, 2010

CONSUMER FEDERATION OF CALIFORNIA

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CERTIFICATE OF SERVICE

I hereby certify that on May 17, 2010, I served by e-mail all parties on the service lists for R.09-04-012 for which an email address was known, true copies of the original of the following document which is attached hereto:

**REPLY COMMENTS OF THE CONSUMER FEDERATION OF CALIFORNIA
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RE OIR.09-04-012 AND RELATED WORKSHOPS**

The names and e-mail addresses of parties served by e-mail are shown on an attachment.

Dated: May 17, 2010

Respectfully submitted,

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